

Public Safety Retirement System COLA – Briefing

Prepared for the Retirement and Independent Entities Committee

By The Office of Legislative Research and General Counsel – November 2007

What is a retirement cost-of-living adjustment?

A COLA (cost-of-living adjustment) for retirement allowance purposes, provides an increase to a retirement allowance in order to reduce the negative impact of inflation over time. For several decades, COLAs have been an integral part of planned adjustments to an otherwise fixed retirement allowance in retirement systems. For example, in 1967, the Legislature passed H.B. 45, "Cost-of-Living Adjustment – Police Pension," which allowed city commissions or city councils to give a cost-of-living adjustment to "restore the full purchasing power of each person's original unmodified pension allowance . . . computed from the consumers price index"

What is the recent history of cost-of-living adjustments?

The table below shows the recent history of the COLA for three of the Utah State Retirement Systems.

| *COLA History Utah State Retirement Systems – Public Employees, Public Safety, and Firefighters Systems | | | | |
|--|-----------------------------|------------------------------------|---------------------|---|
| Year of Passage | Public Employees | Public Safety Employees | Firefighters | Bill Number/(Notes) |
| 1967** | up to 1.0% | – | – | S.B. 205, "Public Employees Retirement System" |
| 1973** | up to 1.5% | – | – | S.B. 59, "Amendment to Utah State Retirement Act" |
| 1975 | up to 4% | – | – | S.B. 51, "State Retirement Benefit and Contribution Increase" |
| 1979*** | " | up to 2.5% | up to 2.5% | H.B. 67, "Public Safety Retirement Cost-of-Living Adjustment" H.B. 66, "Fireman's Pension Cost-of-Living Adjustment" |
| 1994 | " | " | up to 4% | S.B. 219, "Firefighters Pension Cost-of-Living Adjustment" |

* All percentages are annual maximum increases to the original retirement allowance (simple interest). Increases in excess of maximum percentages are accumulated and used in years when the Consumer Price Index is less the maximum.

** See text above for additional detail.

*** Both of the 1979 bills required a retiree to have reached age 65 in order to qualify for the cost-of-living adjustment. The age requirement was removed in both systems in 1981 with the passage of S.B. 144, "Public Safety Retirement Benefits," and H.B. 131, "Modification of Firemen's Retirement Benefits."

What other background should be considered?

1. Public Safety employees and Firefighters have enhanced benefits

In 1983, the Legislature passed sweeping benefit enhancements to both the Public Safety and Firefighter Systems with the passage of S.B. 26 "Public Safety Retirement Amendments" and H.B. 271 "Modifications to Firemen's Retirement Act." The table below summarizes these changes in eligibility and retirement multiplier provisions.

| Current Provisions for Public Safety and Firefighters Beginning Mid 1983 | Pre-1983 Public Safety | Pre-1983 Firefighters |
|--|--|--|
| Eligibility (years of service credit): any age and 20 years age 60 and 10 years age 65 and 4 years | age 50 and 25 years age 55 and 20 years age 62 and 10 years age 65 and 4 years | age 50 and 25 years age 55 and 20 years age 62 and 10 years age 65 and 4 years |
| Multiplier: 2.5% for 1st 20 years 2.0% for years above 20 70% maximum benefit reached at 30 years | 2.0% for 1st 25 years 1.0% for years above 25 1.5% if age 62 to 64 with 10 years but less than 20 years 70% maximum benefit reached at 40 years | 2.0% for 1st 25 years 1.0% for years above 25 1.5% if age 62 to 64 with 10 years but less than 20 years 70% maximum benefit reached at 40 years |

For an employee with 30 years of service credit, the 1983 benefit enhancements resulted in receiving a retirement allowance of 70% of final average salary instead of 55%, a 27% increase. The extra cost was to be paid by increases in employee contributions.

While a public safety employee (and a firefighter) who retired in 1983 with 30 years of service would get 70% of final average salary under these enhancements, a regular public employee who retired at the same time with identical years of service would get 41.4% of final average salary based on applicable retirement multipliers for public employees.

A person who retired in 2007 with 30 years of service would get:

- 70% of final average salary in the public safety (and firefighters) system; and
- 60% in the public employees systems.

2. Costs and Funding Differ Between Systems

By 1989, when the Legislature passed S.B. 153 "Noncontributory Retirement System for Public Safety," creating the "Public Safety Noncontributory Retirement

System" the employer was paying, in most cases, the employee's contributions¹.

Whether an employer or an employee makes retirement contributions and at what share, are questions that are typically considered when negotiating total compensation packages. Note that for firefighters, there is no noncontributory retirement system and more than half of firefighters retirement is funded by a fire insurance premium tax.

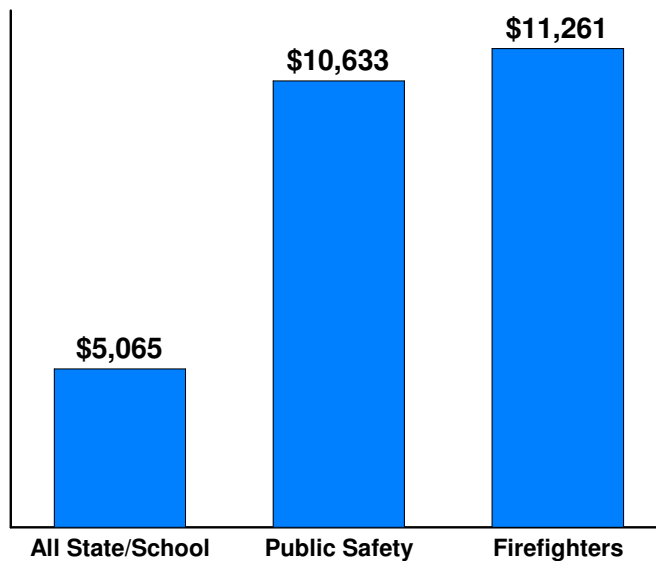
As shown on the adjacent chart, the average annual retirement contribution per employee varies because of the differing:

- level of benefits;
- historical funding requirements of the various funds; and
- average salary of the various types of employees.

Note that in 2006, the cost for a public safety employee retirement contribution was more than double that of a public or school employee.

Average Annual Retirement Contribution Per Employee

Calendar Year Ending Dec. 31, 2006



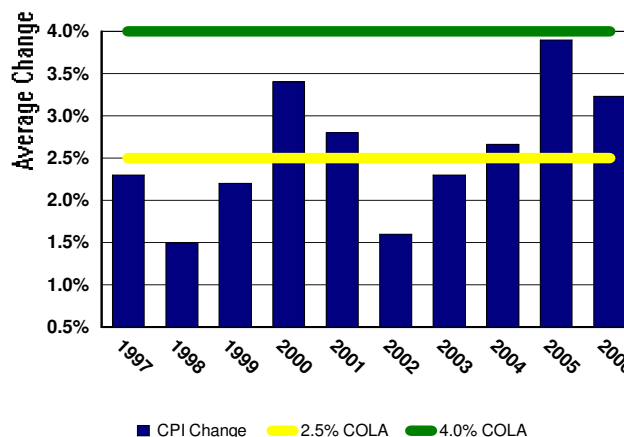
Source: Utah State Retirement Systems Aug. 20, 2007

3. Recent historic Consumer Price Index increases have been relatively low

Although over the last 41 years, the CPI (Consumer Price Index) has risen by an annual average of 4.7%, as shown in the adjacent chart, in the last 10 years the CPI has risen at a much slower rate (an annual average of only 2.6%). Under Utah law, CPI increases in excess of maximum percentages (2.5% for Public Safety retirees) are accumulated and used in years when inflation is less than 2.5%. This means that the actual harm

Consumer Price Index -- All Urban Consumers

COLA 2.5% vs. 4.0%



U.S. Department of Labor, Bureau of Labor Statistics, Sept. 17, 2007

¹History of the Utah Retirement Systems p. 124, Utah Retirement Systems, Salt Lake City, Utah, 2005

for Public Safety retirees for not having a 4.0% COLA since 1994, has been in the delay in getting COLAs and not in the 2.5% cap itself. However, the CPI changes in past years are no guarantee of future trends, including the possibility of higher than normal inflation rates, which would result in significant unfunded cost-of-living increases for Public Safety retirees.

What is the cost of increasing the maximum Public Safety COLA from 2.5% to 4%? Who must pay for the increase? (This section prepared by The Office of the Legislative Fiscal Analyst)

Raising the maximum Public Safety COLA to 4% will result in the accrual of new costs to the Public Safety Retirement System because:

- pension benefits will increase for public safety retirees; and
- active member contribution rates are based on funding for a 2.5% COLA.

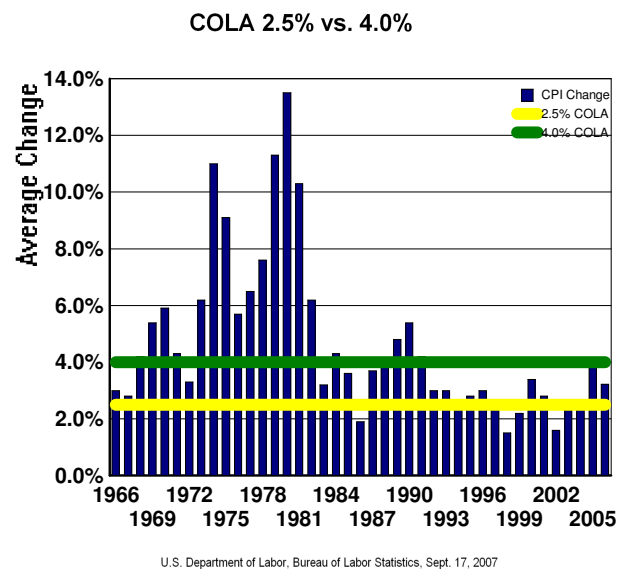
The magnitude of the increase in benefits will vary among individual retirees based on initial allowances, the time of retirement, and annual changes in the Consumer Price Index after retirement.

In order to fund an increase in the maximum Public Safety COLA, Utah Retirement Systems would have to raise the contribution rates for active employees of the 120 entities participating the Public Safety Retirement System. The rate increases and associated dollar amounts are outlined in the following table. The total cost to the State is approximately \$3.1 million annually. Costs to individual local entities vary, but total to about \$5.9 million annually. Since the State covers the entire retirement contribution, the rate increase would not directly impact State employees. Local public safety employees, however, may share increased costs with their employer if they pay a portion of their retirement contributions.

Estimated Costs Associated with Changing the Public Safety Retirement System Maximum COLA from 2.5% to 4%

| Employer | Contribution Rate Increase | Annual \$ Value of Increase | State Funding Sources | | | |
|-----------------------|----------------------------|-----------------------------|-----------------------|-------------------|------------------|-------------------|
| | | | General Fund | Dedicated Credits | Restricted Funds | All Other Sources |
| State of Utah | 2.66% | \$2,644,900 | \$2,347,000 | \$104,600 | \$177,000 | \$16,300 |
| All Local Entities | varies | \$5915,485 | (funded locally) | | | |
| All Other Division A* | 2.27% | 3,708,00 | (funded locally) | | | |

Consumer Price Index -- All Urban Consumers



| | | | |
|-----------------------|-------|-----------|------------------|
| Salt Lake City | 3.33% | \$898,000 | (funded locally) |
| Ogden | 3.81% | \$211,600 | (funded locally) |
| Provo | 3.02% | \$148,794 | (funded locally) |
| Logan | 2.99% | \$80,800 | (funded locally) |
| Bountiful | 3.38% | \$60,100 | (funded locally) |
| All Other Division B* | 2.22% | \$807,300 | (funded locally) |

*Division A entities participate in Social Security, Division B entities do not.

Note: Data on which this analysis is based do not break out salary bases between noncontributory and contributory plans, thus the noncontributory rate increase is applied in this analysis (contributory increases are slightly less), except for Bountiful.

This does not represent a final fiscal note from the Office of the Legislative Fiscal Analyst. It is given as an estimate of potential impacts from proposed legislation. Further information, which could come available before this bill is numbered, may change this estimate.

Source: Office of the Legislative Fiscal Analyst analysis of Utah Retirement Systems and Division of Finance Data, January 2007